



**UNITED STATES OF AMERICA  
DEPARTMENT OF TRANSPORTATION  
OFFICE OF THE SECRETARY  
WASHINGTON, D.C.**

Issued by the Department of Transportation  
on the 16<sup>th</sup> day of August, 2002

Essential air service at

**EL DORADO/CAMDEN, ARKANSAS  
JONESBORO, ARKANSAS  
HARRISON, ARKANSAS  
HOT SPRINGS, ARKANSAS  
ENID, OKLAHOMA  
PONCA CITY, OKLAHOMA  
BROWNWOOD, TEXAS**

**Served: August 21, 2002**

**Docket OST-1997-2935**

**Docket OST-1997-2401**

**Docket OST-1997-2402**

under 49 U.S.C. 41731 *et seq.*

**ORDER DENYING PETITION FOR RECONSIDERATION  
AND MOTION FOR STAY**

**Summary**

By this order, the Department is denying the petition for reconsideration and motion to stay the effectiveness of Order 2002-7-2, July 1, 2002, filed by Big Sky Transportation Co., d/b/a Big Sky Airlines. Order 2002-7-2 had selected Air Midwest, Inc., a subsidiary of Mesa Air Group, Inc., to replace Big Sky to provide subsidized essential air service at seven communities in Arkansas, Oklahoma and Texas.

**Background**

By Order 2002-2-9, February 11, 2002, the Department tentatively reselected Big Sky to provide subsidized essential air service at the seven communities listed above for the two-year period beginning December 1, 2001, at annualized subsidy rates totaling about \$8.1 million during the first 6 months and \$7.8 million during the remaining 18 months.<sup>1</sup> Consistent with normal program policy, the order also provided for objections to our tentative decision, and invited competing proposals from other carriers interested in providing service at the communities, with or without subsidy.

The Department received competing proposals from two carriers: from Corporate Airlines, Inc., and a late-filed proposal from Mesa Air Group on behalf of its subsidiary Air Midwest. Following discussions with Department staff, Corporate agreed to a final proposal containing several options covering service at five of the seven communities, excluding Enid and

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<sup>1</sup> See Appendix A for a map.

Brownwood, with subsidy requirements ranging from \$6.9 to \$8.4 million a year, depending on the particular option involved. Mesa proposed the same service patterns and levels as Big Sky but operated with 19-seat Beech 1900 aircraft rather than the 19-seat Metro III and Metro 23 aircraft used by Big Sky, with a subsidy requirement of about \$6.7 million a year. In view of the competing proposals, Big Sky was given the opportunity to amend its own earlier proposal, but ultimately decided to maintain the terms and conditions, including the subsidy requirement of \$7.8 million a year, for which it had been tentatively selected by Order 2002-2-9. In letters dated May 29, 2002, the Department presented all three carriers' final proposals to the affected communities and requested their final comments.<sup>2</sup>

Following receipt of the communities' final comments, the Department selected Air Midwest to replace Big Sky by Order 2002-7-2, based on Air Midwest's lower subsidy requirement and strong community support. Five of the seven communities -- El Dorado/Camden, Harrison, Hot Springs, Enid and Brownwood -- supported the selection of Air Midwest unequivocally. Jonesboro preferred Corporate first, Air Midwest second, and Big Sky third. Ponca City expressed no preference; it instead expressed some reservations about both Air Midwest and Big Sky, and was silent regarding Corporate.<sup>3</sup>

On July 22, 2002, Big Sky filed a petition for reconsideration and motion to stay the effectiveness of Order 2002-7-2, in which it asks that the Department reverse its decision and select Big Sky to continue providing subsidized service at the communities. The Mayor of Ponca City has filed an answer in support of Big Sky's petition, and Mesa has filed an answer opposing it on behalf of Air Midwest.

#### **Big Sky's Petition for Reconsideration and Motion for Stay**

In its petition, Big Sky states that Mesa's proposal should have been rejected as procedurally deficient because it was filed late, and that Mesa neither asked for an extension beforehand nor requested leave to file late when it did file.

Big Sky also says that community support for Mesa "appears to have been premised on misleading information provided by Mesa/Air Midwest to communities that had earlier pledged support to Big Sky." Big Sky states that, early in the proceeding, it had the support of three communities -- Harrison, Ponca City and Brownwood. Big Sky believes that these communities may have changed their positions later for three reasons: first, because Mesa falsely claimed that its aircraft were newer than Big Sky's; second, because Mesa may have told the communities that it could begin service within 30 days of a Department decision, although Mesa told the Department that start-up would require 60 to 90 days; and third, because Mesa was soliciting

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<sup>2</sup> Corporate's and Mesa's *initial* proposals were public, as of course was Big Sky's proposal as presented in Order 2002-2-9. However, the carriers' *final* proposals were not made public until the Department presented them to the affected communities.

<sup>3</sup> In his letter dated June 17, 2002, the Mayor of Ponca City said that he was concerned "about the age of [Big Sky's] fleet and resulting diminished convenience to passengers." On the other hand, he also expressed concern that "Mesa will not be able to develop the increased passenger numbers [that it projected] and [will] ask for relief from [the Department,] thus posing the risk of interruption of service and uncertainty about which carrier would service our community."

community support based on the subsidy proposal submitted to the Department, which Big Sky characterizes as faulty and unrealistic.

With respect to Mesa's subsidy proposal, Big Sky states that it fails the test for reasonableness required by 14 CFR Part 271. In particular, Big Sky states that Mesa's final proposal includes \$1.6 million more revenue than its initial proposal did, and that \$1.0 million of that amount is completely unsubstantiated, being largely based on a traffic forecast of 48,954 passengers for the seven communities combined. Big Sky notes that Mesa's traffic projection is 36 percent above its own experience in calendar year 2001, 31 percent higher than any year since at least 1995, and therefore "exaggerated beyond any realistic, historically accurate level." Big Sky also contends that Mesa's proposal understates its actual costs. Big Sky points to two other recent essential air service cases, one involving service from three communities in upstate New York to Pittsburgh and the other service from four communities in western Kansas to Kansas City, and notes that Mesa's unit costs in the present case are substantially lower than those in the two other cases.<sup>4</sup> According to Big Sky's calculation, if Mesa had projected the same realistic traffic that Big Sky did and used unit costs consistent with those it had used in the two earlier cases, Mesa's subsidy requirement would exceed Big Sky's by more than \$1.5 million a year.

Big Sky believes that the Department's acceptance of Mesa's proposal represents a disturbing program precedent. In Big Sky's view, Mesa could suffer substantial financial losses in operating at the communities because of its understated compensation requirement, and consequently could either attempt to discontinue service at some or all of the communities or demand additional subsidy from the Department as a condition of continuing service, thus jeopardizing the very service that the program is designed to ensure. Big Sky, therefore, petitions the Department to reverse its decision in Order 2002-7-2 and select it over Mesa's subsidiary Air Midwest, as well as over Corporate, to provide subsidized service at the seven communities at issue, and in the meantime to grant its motion for a stay of the effectiveness of Order 2002-7-2 until the issues it has raised are resolved.

#### **Ponca City's Answer**

In support of Big Sky's petition, the Mayor of Ponca City now states that the city favors the continuation of Big Sky's service, and that Big Sky "has traditionally met and even exceed[ed] its commitments to our community." He states that Mesa was upset by his earlier doubts about its proposal, and that, without his knowledge, Mesa attempted to persuade the Public Works Director to oppose the city's stated position. He therefore believes that Mesa's "indignant attitude and surreptitious behavior raise red flags about the quality and duration of Mesa/Air Midwest's service to our community." He also notes that Mesa had initially agreed to honor Big Sky's current contract of \$2,000 per month for use of the city's aircraft maintenance facility, but that Mesa now appears to be "backtracking" on that promise.

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<sup>4</sup> See Orders 2002-2-3, February 5, 2002, and 2002-3-29, March 29, 2002, where Mesa's subsidy rates incorporated total operating costs of \$985 per block hour for upstate New York-Pittsburgh and \$970 per block hour for western Kansas-Kansas City. In comparison, Mesa's proposal in the present case includes total operating costs of \$849 per block hour.

### **Mesa's Answer**

In answer to Big Sky's petition, Mesa states that the Department's acceptance of its late proposal was consistent with longstanding Department policy, and that the brief delay in submitting that proposal caused no prejudice to Big Sky and is no basis for now disturbing the Department's decision in Order 2002-7-2. Mesa also says that the communities' letters in support of Mesa do not cite the various Mesa misrepresentations that Big Sky alleges, and that the sole letter specifically cited by Big Sky, from Ponca City, did not support the selection of Air Midwest in any event. Instead, says Mesa, "the communities' strong collective expression of support for Air Midwest was based on far simpler considerations -- Big Sky had failed to deliver the level and quality of service expected by the communities when it was operating as the incumbent." As for its subsidy proposal, Mesa asserts that it is a highly efficient operation with economies of scale that Big Sky lacks, and that Big Sky's pessimism about Mesa's passenger forecast "is reflective of its own poor operating history." Mesa states that it "stands by the forecast and other assumptions" in its proposal.

### **Decision**

After fully considering the issues raised by Big Sky and the answers from Ponca City and Mesa, we have decided to deny Big Sky's petition for reconsideration and motion for a stay.<sup>5</sup>

As Mesa correctly notes, it has been our consistent practice to accept late-filed proposals to the extent practicable. In our orders requesting proposals for essential air service, including Order 2002-2-9, we routinely note the availability to interested carriers of an explanatory document called "Air Carrier Selection Procedures" that describes our process for handling carrier replacement cases and discusses in detail the process of requesting proposals, conducting reviews of applicants, and selecting a replacement carrier. That document is also included in the package of information we regularly furnish to carriers newly interested in the program generally. As it states:

While carriers may file proposals after the close of the filing period without benefit of an extension, we will consider late-filed proposals only to the extent practicable, and the filing of a late proposal will weigh against its selection. Therefore, we encourage all carriers to make every effort to meet the designated filing date, or to request an extension if they are unable to do so.

Thus, while we encourage timely-filed proposals and requests for extension when necessary, we still make an effort to accommodate those that are filed late. Our practice of accepting late proposals is prompted by our desire to base carrier selection decisions on as many viable service

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<sup>5</sup> Big Sky notes that the bulk of the issues it raises in its petition were the subject of a letter to the Department dated June 24, 2002, and that we ignored that letter when reaching our decision in Order 2002-7-2. However, that letter was not submitted until nearly a month after the carriers' final proposals were made public, after all the communities had already reviewed and commented on those proposals, and when a decision was imminent. We did, in fact, review Big Sky's letter. For the reasons discussed below, however, we found in it no compelling reason for delaying our decision or the carrier transition that most of the communities were urging.

and subsidy options as possible. And in the present instance, we find that Big Sky was not placed at any procedural disadvantage by our acceptance of Mesa's late proposal. Our staff had not yet entered into rate discussions with either Big Sky or Corporate at the time that we decided to accept Mesa's submission on April 15; both carriers were well aware of Mesa's participation in the case, and of the details of its initial proposal, before discussions regarding their own final proposals were under way.<sup>6</sup>

On the other hand, our rejection of Mesa's proposal on grounds of a minor procedural deficiency would have been antithetical to the best interests of the affected communities. Even before the carrier selection proceeding was initiated in February, we were aware that some of the communities were very dissatisfied with Big Sky's performance and were actively recruiting other carriers. On December 12 of last year, for instance, a group of business leaders from El Dorado met with Department staff to voice their unhappiness with Big Sky and their hopes of attracting another carrier. Early in the proceeding, we received numerous letters from a core of three cities -- El Dorado, Hot Springs and Jonesboro -- as well as members of their Congressional delegations favoring the selection of Corporate, at a time when the communities were hoping that Corporate would obtain a code-share alliance with Northwest Airlines, Inc. When that alliance failed to materialize, El Dorado and Hot Springs immediately threw their support behind Air Midwest.<sup>7</sup> In addition, the Mayor of Brownwood submitted a letter dated March 20 supporting Air Midwest -- even before we had decided to accept Mesa's late proposal - in which he explained that Brownwood's earlier endorsement of Big Sky was simply based on Big Sky's being the only carrier previously interested in serving the community.<sup>8</sup> At that point, it was becoming clear that a majority of communities preferred any alternative to Big Sky. Only Harrison submitted an early letter endorsing Big Sky, and Harrison's letter was dated February 26, which predated not only our acceptance of Mesa's proposal, but the March 6 date for timely-filed proposals. By the time we asked for the communities' final comments, Harrison had changed its preference to Air Midwest, and Enid, which had previously been silent, also expressed a preference for Air Midwest.

Ponca City has now abandoned its earlier noncommittal stance and voiced its support for Big Sky, but is the only community to express dissatisfaction with Mesa. Ponca City's comments about Mesa do concern us, and we expect Mesa to work closely with Ponca City as well as the other communities to honor its commitments and provide reliable service. We would particularly urge Mesa to take note of the fact that our selection of its subsidiary, Air Midwest, was based in no small part on community dissatisfaction with Big Sky.

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<sup>6</sup> See also Orders 91-1-21, January 11, 1991, and 98-10-9, October 7, 1998. In the latter case we accepted a late proposal from Yute Air Alaska, Inc., to provide subsidized service at the very communities at issue here, but we ultimately selected Big Sky. Big Sky did not object to Yute Air's late filing.

<sup>7</sup> Corporate continued to be Jonesboro's first choice because Corporate's proposal included an option under which it would operate as an American Connection code-share to St. Louis, but Jonesboro, nonetheless, preferred Mesa as a second choice over Big Sky.

<sup>8</sup> As noted earlier, Corporate's proposal did not include service for Brownwood or Enid.

Nonetheless, six of the seven communities continue to prefer Air Midwest. And as discussed above, several of them were opposed to a continuation of Big Sky's tenure before the proceeding had even begun. Furthermore, only Ponca City has come forward to express support for Big Sky's contention that Mesa misrepresented itself to the communities.<sup>9</sup>

We remain comfortable with the prospect that Mesa will be able to sustain service at its proposed subsidy rate. We disagree that the traffic projections in Mesa's proposal are unrealistic. For example, Big Sky notes that Mesa's traffic projections are 36 percent above what Big Sky achieved in calendar year 2001. However, in view of the dissatisfaction with Big Sky's reliability expressed by several of the communities, we find it entirely reasonable that a competing carrier would demonstrate confidence in its own ability to provide more reliable service by forecasting an improvement in ridership. A 36-percent traffic improvement over Big Sky's performance might seem substantial at first glance, but the markets at issue are very thin: a 36-percent increase in markets that averaged only 8.2 enplanements a day during calendar year 2001 amounts to an improvement of just 3.0 enplanements a day per community. And such an improvement must also be viewed in the context of total local demand for scheduled air service. Improving traffic at a community's local airport by 3.0 enplanements a day does not require a major shift in the proportion of local travelers using that airport versus those driving to other airports.

Our review of the communities' historical traffic results indicates that Mesa's projections are attainable. Mesa's projected traffic for the seven communities in the aggregate is slightly below actual traffic results achieved in the early 1990s by Express Airlines II, Inc., d/b/a Lone Star Airlines, which was frequently in financial trouble, later sold, and eventually went out of business. At no individual community is Mesa's projection more than three enplanements a day above what Lone Star was able to achieve, and Mesa's projections are actually below Lone Star's results at El Dorado/Camden, Hot Springs and Harrison.<sup>10</sup>

We are not persuaded that Mesa's cost projections are unreasonable. It may or may not be true that Mesa's projections reflect fully allocated costs, but reasonable costs and fully allocated costs are not synonymous. In fact, Part 271 specifically provides for incremental costing in cases where a carrier proposes to add a community to an existing linear route. But in a competitive environment, other costing approaches may also be reasonable. For example, a carrier faced with a situation where its fleet is underutilized can make an entirely sound economic decision by putting aircraft to work in markets where revenues, including subsidy, will not cover fully allocated costs, provided that the carrier's overall losses are reduced as a result -- i.e., it can make more sense to utilize aircraft at a small loss than not to utilize them at all. We do not know

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<sup>9</sup> Even if Big Sky were willing to remain at Ponca City alone, the program cost of subsidizing Big Sky there while subsidizing Air Midwest at the other six communities would be prohibitive. The subsidy required for Big Sky's service at Ponca City alone would be very high by program standards, and we would also be separately subsidizing Air Midwest to serve nearby Enid. The two carriers would thus be operating over virtually identical routes at a total subsidy at least double that required by Air Midwest to serve both communities.

<sup>10</sup> See Appendix B for a comparison of Mesa's projected traffic with Lone Star's historical results.

whether this, in fact, represents Mesa's thinking, but such an approach would be consistent with its recent decision to pursue opportunities in the essential air service program more aggressively.<sup>11</sup> In this regard, we would note that Mesa's proposals for upstate New York and the western Kansas-Kansas City routes, which Big Sky cites as including higher costs, were both submitted before the proposal at issue here. And in both cases, Mesa was the incumbent rather than a competitor, and we would expect competition to produce lower subsidy proposals. On the other hand, it is true that Mesa's more recent competitive proposals have been inconsistent. For example, its proposal for the western Kansas-Denver routes contains unit costs identical to those in the present case, but its proposal in another case, involving Beckley and Bluefield/Princeton, West Virginia, contains higher costs.<sup>12</sup> We are closely monitoring Mesa's bidding behavior and its commitment to honoring the subsidy rates it proposes, as well as its working relationships with the communities it serves.

There are, however, both statutory provisions and practical considerations that strongly discourage carriers in competitive cases from proposing subsidy rates that they have no intention of honoring over the full course of a two-year rate term. A carrier already receiving subsidy for service can only trigger a review of its subsidy rate during the course of a rate term by filing a 90-day notice to suspend service. In doing so, the incumbent carrier makes itself vulnerable to competitive proposals from other carriers. In addition, 49 U.S.C. 41734(e) stipulates that the incumbent does not become eligible for a revised rate until 180 days after filing notice -- in other words, for nearly six months, which represents a full quarter of the usual two-year term. And in Mesa's particular case, we would point out that the carrier is an active participant in the essential air service program; it already provides subsidized service at more than a dozen communities, will shortly be adding the seven at issue here, and has several other proposals pending for additional markets. We expect that Mesa understands that a failure to sustain its proposal in one competitive case would undermine its credibility in others.

We remain appreciative of Big Sky's participation in the program, and particularly the willingness it showed two years ago to enter the markets at issue on short notice and under very difficult circumstances, when Aspen Mountain Air, formerly Lone Star, filed for bankruptcy and ceased operations. However, the Department simply cannot overlook the strong community opposition to Big Sky or the opportunity to save \$2.2 million in program funding over the next two years, so long as we believe that Mesa's proposal stands a reasonable chance of being sustained.

This order is issued under authority delegated in 49 CFR 1.56a(f).

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<sup>11</sup> According to a recent Mesa 10-Q Report, it had 21 surplus Beech 1900D aircraft as of March 31, 2002. And Big Sky itself acknowledges that these aircraft "have been on Mesa's balance sheet for many years and have been identified by Mesa as surplus aircraft that Mesa has wanted to liquidate since 1998." Big Sky petition at 11.

<sup>12</sup> See Dockets OST-1998-3497, 3498, 3502 and 3503 for Mesa's proposal in the western Kansas-Denver case, and Docket OST-1997-2601 for its proposal regarding Beckley and Bluefield/Princeton, West Virginia.

**ACCORDINGLY,**

1. We deny the petition for reconsideration and motion to stay the effectiveness of Order 2002-7-2, July 1, 2002, filed by Big Sky Transportation Co., d/b/a Big Sky Airlines, in Dockets OST-1997-2935, OST-1997-2401 and OST-1997-2402;
2. These dockets will remain open until further order of the Department; and
3. We will serve copies of this order on the mayors and airport managers of El Dorado/Camden, Jonesboro, Harrison and Hot Springs, Arkansas, Enid and Ponca City, Oklahoma, and Brownwood, Texas; Air Midwest, Inc.; Big Sky Transportation Co., d/b/a Big Sky Airlines; and Corporate Airlines, Inc.

By:

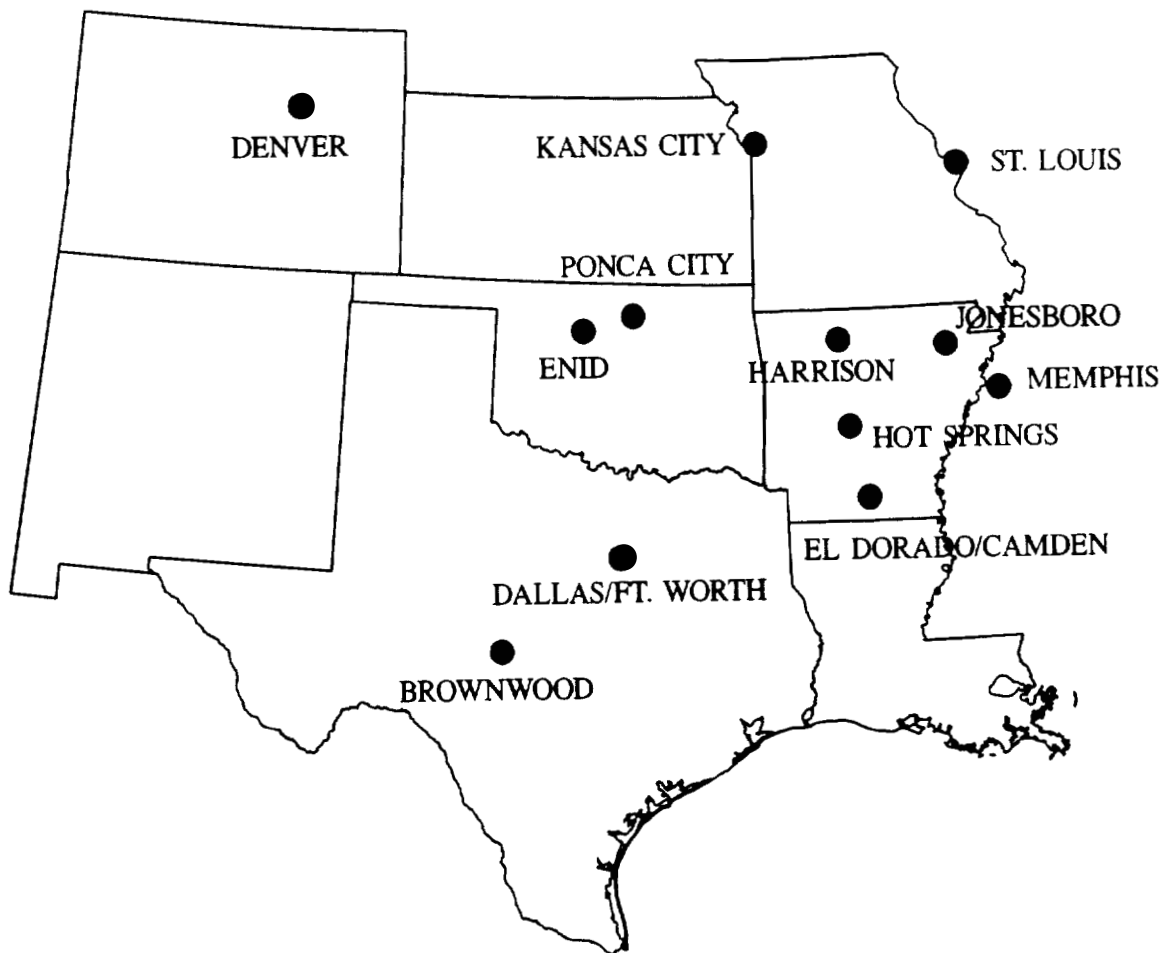
**READ C. VAN DE WATER**  
Assistant Secretary for Aviation  
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(SEAL)

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# MAP



## APPENDIX B

## ENPLANEMENTS PER DAY

<u>COMMUNITY</u>	<u>WITH LONE STAR</u>		<u>MESA PROJECTION</u>
EL DORADO/CAMDEN	12.7	1991	7.5
JONESBORO	11.2	1994	11.8
HOT SPRINGS	14.9	1994	9.6
HARRISON	11.5	1992	10.2
ENID	12.1	1994	14.3
PONCA CITY	13.3	1994	14.2
BROWNWOOD	6.4	1994	9.3
TOTAL	81.8		76.9

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Enplanements represent one-half of total origin-and-destination traffic, and averages are based on 313 weekdays and weekends each year. The historical traffic figures are from *Study of Air Service at Small Communities: 1978-1995*, U.S. Department of Transportation, Office of Aviation and International Affairs, May 1996.